

IRS News Release

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IRS Provides Guidance on Per Diem Expense Reimbursements Paid By Employers

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WASHINGTON — The Internal Revenue Service today issued guidance emphasizing the need for employers to track the amount of expense reimbursement allowances paid to employees on a per diem basis.

Revenue Ruling 2006-56 tells employers that if they routinely pay per diem allowances in excess of the federal per diem rates, but do not track the allowances and do not require the employees either to actually substantiate all the expenses or pay back the excess amounts, and do not include the excess amounts in the employee's income and wages, then the entire amount of the expense allowances is subject to income tax and employment tax.

Generally, amounts employers pay employees to reimburse them for substantiated business expenses are not subject to income tax or employment tax. For reimbursements for expenses for meals and other incidentals associated with business travel, employees get this exclusion for reimbursements for each day of travel up to the federal per diem rates without having to actually substantiate the amounts of the expenses. However, if an employer pays expense allowances that exceed the federal per diem rates, the excess amounts are subject to income tax and employment tax if they are not repaid to the employer, unless the employee actually substantiates all of the expenses covered by the per diem allowance.

The revenue ruling illustrates when a per diem allowance arrangement that fails to track the excess amounts and does not include the unsubstantiated, unrepaid excess amounts in the employee's income and wages constitutes a pattern of abuse of the rules for tax-free expense reimbursements. The finding that the arrangement is abusive causes all allowances paid under the arrangement to be subject to income tax and employment tax, not just the excess amounts. While the revenue ruling uses a scenario in the trucking industry because of the industry's widespread use of per diem allowances, the analysis in the revenue ruling applies to any employer in any industry that uses per diem allowances to reimburse employee expenses.

IRS Revenue Ruling 2006-56 is effective immediately upon issuance. However, the IRS recognizes that employers may need some time to adjust their systems so they can track excess allowances and account for them correctly. The IRS is issuing instructions to its agents not to apply the results under the revenue ruling for taxable periods ending on or before Dec. 31, 2006, in the absence of intentional noncompliance.